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AZ CORP COMMISSION  
DOCKET CONTROL

2017 APR -3 P 3: 58

**BEFORE THE ARIZONA CORPORATION COMMISSION**

**COMMISSIONERS**

Arizona Corporation Commission

**DOCKETED**

DOUG LITTLE, Chairman

BOB STUMP

BOB BURNS

ANDY TOBIN

TOM FORESE

APR 3 2017

DOCKETED BY

*GB*

IN THE MATTER OF THE  
APPLICATION OF ARIZONA PUBLIC  
SERVICE COMPANY FOR A HEARING  
TO DETERMINE THE FAIR VALUE OF  
THE UTILITY PROPERTY OF THE  
COMPANY FOR RATEMAKING  
PURPOSES, TO FIX A JUST AND  
REASONABLE RATE OF RETURN  
THEREON, TO APPROVE RATE  
SCHEDULES DESIGNED TO DEVELOP  
SUCH RETURN

Docket No. E-01345A-16-0036

IN THE MATTER OF FUEL AND  
PURCHASED POWER PROCUREMENT  
AUDITS FOR ARIZONA PUBLIC  
SERVICE

Docket No. E-01345A-16-0123

**NOTICE OF FILING DIRECT  
TESTIMONY OF JAMES D.  
DOWNING IN OPPOSITION TO  
THE SETTLEMENT AGREEMENT**

Electrical District Number Eight and McMullen Valley Water Conservation & Drainage  
District (hereinafter collectively referred to as "ED8/McMullen"), through its undersigned

1 counsel, hereby provides notice that it has this day filed the attached Direct Testimony of  
2 James D. Downing in Opposition to the Settlement Agreement.

3 DATED this 3<sup>rd</sup> day of April, 2017.

4  
5 MOYES SELLERS & HENDRICKS

6  
7 

8 Jason Y. Moyes  
9 Jay I. Moyes

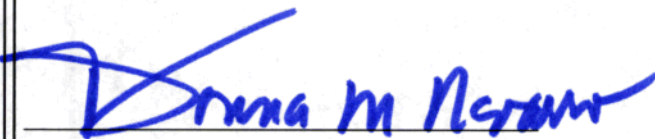
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16 ORIGINAL and 13 COPIES of  
17 the foregoing filed this  
18 3<sup>rd</sup> day of April, 2017, with:

19 Docket Control  
20 Arizona Corporation Commission  
21 1200 West Washington  
22 Phoenix, Arizona 85007

23 COPIES of the foregoing  
24 Electronically mailed this  
25 3<sup>rd</sup> day of April, 2017, to:

26 All Parties of Record.

27 

**DIRECT TESTIMONY IN OPPOSITION TO SETTLEMENT AGREEMENT  
OF JAMES D. DOWNING ON BEHALF OF  
ELECTRICAL DISTRICT NUMBER EIGHT AND MCMULLEN VALLEY  
WATER CONSERVATION & DRAINAGE DISTRICT  
No. E-01345A-16-0036 and E-01345A-16-0123**

**I. INTRODUCTION**

**Q: PLEASE STATE YOUR NAME, ADDRESS AND OCCUPATION.**

**A:** My name is James D. Downing. My business address is 66768 Hwy 60, Salome, AZ 85354. I am a licensed Professional Engineer.

**Q: HAVE YOUR QUALIFICATIONS AND BACKGROUND BEEN PREVIOUSLY DESCRIBED IN THIS PROCEEDING?**

**A:** Yes. My Statement of Qualifications was attached to the direct testimony I filed on behalf of Electrical District Number Eight and McMullen Valley Water Conservation & Drainage District ("ED8/McMullen") on December 28, 2016.

**II. SUMMARY**

**Q: WHAT IS THE PURPOSE OF YOUR TESTIMONY?**

**A:** The purpose of my testimony is to oppose the Settlement Agreement reached between APS, Staff, RUCO, and a number of intervenors in this case. Simply put, I do not agree with how settlement is reached in these rate cases. As the settlement process now moves to the hearing stage, and the proponents offer detailed data and rationale in support of the settlement, I urge a step back to a broader perspective on the premise and process of this settlement.

**III. DIRECT TESTIMONY**

**Q: DO YOU FEEL THE SETTLEMENT PROCESS ITSELF IS FLAWED?**

**A:** Yes. The entire settlement process seems premised on an assumption that "because APS has *filed* a rate case, revenues and rates *must* increase"; and that the only questions are: "how *much* increase, and by means of *which* rate design components?"

1  
2 Q: **WHY DO YOU FEEL SUCH AN ASSUMPTION IS AUTOMATICALLY**  
3 **MADE?**

4 A: I've wondered that for many years. Is it simply because this has become the  
5 consistent precedent for many consecutive rate cases? Surely there should not be  
6 an automatic increase *merely* because APS has *asked* for more revenues.

7 Q: **IS APS ENTITLED TO ASK FOR A RATE INCREASES AT ANY TIME?**

8 A: It is true that, under the governing rules, APS can *ask* for anything, and ask as often  
9 as it wishes to go to the effort and expense of doing so. But, because APS *has*  
10 *asked* for more, it is APS' burden to prove *why*, and how much – *if any* – increase is  
11 justified. Nothing should be assumed from the mere fact that APS has asked for an  
12 increase. One should only assume that APS' voluminous filing will have been  
13 prepared and presented in its most favorable light to persuade the Commission to  
14 grant the requested increases and other proposed concessions.

15 Q: **IS ANYONE CHARGED WITH EXAMINING WHETHER APS' REQUEST**  
16 **FOR A RATE INCREASE IS JUST AND REASONABLE?**

17 A: Before the Commission makes the ultimate decision as to whether a rate increase is  
18 approved, Commission Staff (Staff) and the Residential Utility Consumers Office  
19 (RUCO) have the initial legal duty to analyze APS' filing, and to first question *why*  
20 -- before saying *how much*? Why any increase? Why not a decrease?

21 Q: **DID STAFF AND RUCO PERFORM ANY SUCH ANALYSIS IN THIS**  
22 **CASE?**

23 A: In the instant case, true to historical precedent, APS filed its thousands and  
24 thousands of pages of data and direct testimony. And Staff and RUCO each hired  
25 expensive, seasoned outside experts to analyze APS' filed case. The expert  
26



1 analyses of *both* of these tax-funded agencies answered the first question with an  
2 unequivocal "NO!" No justification for increased revenue requirement and rates.  
3 No need for higher ROE, increased profits or increased shareholder equity. No  
4 present need for the Ocotillo plant "modernization" –expansion – with deferral to  
5 future prudence determination. No cost deferral for recovery related to the Four  
6 Corners Power Plant or changes in Arizona property taxes.

7 Q: CAN YOU CITE TO SPECIFIC EXAMPLES FROM STAFF AND RUCO'S  
8 DIRECT TESTIMONY WHERE THEY DISAGREED WITH APS'  
9 REQUESTS?

10 A: Yes. When asked what revenue increase Staff recommended, Staff's expert  
11 witness, Ralph C. Smith, responded as follows:

12 APS's filing requests a \$433.4 million base rate increase (before  
13 transferring adjustor mechanisms of \$267.6 million into base rates)  
14 and a \$165.9 million net base rate increase (after accounting for dirt  
15 adjustor mechanisms transfer into base rates). In comparison, Staff  
16 recommends a base rate revenue increase of approximately \$267.5  
17 million on adjusted Fair Value rate base ("FVRB") (before  
18 transferring adjustor mechanisms of \$267.6 million into base rates).  
19 After accounting for the impact of transferring adjustor mechanisms  
20 into base rates (of \$267.6 million of revenue requirements), Staff's  
21 recommendation equates to a net base rate decrease of  
22 approximately \$74,000. However, Staff is recommending no rate  
23 change other than rolling in due revenues associated wider the  
24 Adjustor Mechanisms.<sup>1</sup> (Emphasis added).

25 Another Staff expert witness, David C. Parcell, concluded that APS's Return on  
26 Equity ("ROE") request was significantly higher than industry standards and was  
based on flawed analysis:

Based upon these findings, I conclude that APS' ROE is within a  
range of 9.2 percent to 9.5 percent (9.35 percent mid-point), which  
is based upon the upper end of the range of the results for the DCF  
model and the mid-point of the range of results for the CE model. **I  
recommend the mid-point of this range, or 9.35 percent, as APS'  
ROE.**

<sup>1</sup> Direct Testimony of Ralph C. Smith, p. 7.

1  
2 I also show that APS' witness Bents Villadsen has over-stated the  
3 Company's COC in her 10.50 percent ROE recommendation and  
4 8.13 percent COC recommendation. **Dr. Villadsen's CAPM, DCF  
and risk-premium analyses include an upward bias as a result of  
several improper adjustments and data sources she employs.**<sup>2</sup>  
(Emphasis added).

5 Nevertheless, despite their expert analysis to the contrary, Staff now agrees  
6 with a ROE for APS of 10.0%—a percentage that is still far higher than  
7 industry standards, according to widely accepted models for similar utilities.

8 Similarly, RUCO's expert witness, Frank Radigan, also concluded  
9 that APS' requests were not justified:

10 The Residential Utility Consumer Office ("RUCO") recommends  
11 rates that produce total operating revenue of \$3.295 billion an  
12 increase of \$243 million from the RUCO-adjusted test year revenue  
13 of \$3.052 billion. RUCO's recommended revenue will provide  
14 operating income of \$485.6 million and a 5.36 percent return on the  
\$9.655 billion RUCO-adjusted FVRB (see RUCO Schedule FWR-1).  
**RUCO recommends allowing all adjustor revenues to be  
transferred to base rate which results in RUCO's recommended  
net base rate decrease of \$24.6 million.**

Other items:

15 RUCO recommends **denial of the requested Ocotillo Deferral** at  
this time.

16 RUCO recommends **denial of the requested Four Corners  
Deferral** and Step Increase at this time.

17 RUCO recommends **denial of the requested Property Tax  
Deferral** at this time.<sup>3</sup> (Emphasis added).

18 Speaking of the Settlement Agreement that was approved in the last APS  
19 rate case, this same RUCO expert concluded:

20 All of these provisions of the settlement gave the Utility enhanced  
21 cash flow and strengthened its balance sheet. In return for all these  
22 advantages to the Utility the Company was able to cut costs and  
23 remain out of the rate case environment for five years instead of the  
four that was mandated by the settlement. **In this case, however, the  
Company does not offer anything to ratepayers for the requested  
financial protections.**

24 ...  
25 **In sum, the filing as presented offers ratepayers less than what**

26 <sup>2</sup> Direct Testimony of David C. Parcell, p. 3.

<sup>3</sup> Direct Testimony of Frank Radigan, p. ii.

1           **they had under the previous settlement and therefore many of the**  
2           **aspects the Company seeks should not be allowed to be put in**  
3           **place** as they are more appropriate as a part of a balanced multi-year  
            rate plan that gives something to both ratepayers and the Utility.<sup>4</sup>  
            (Emphasis added).

4           Staff's and RUCO's experts' answers were clear: APS' filed case failed to  
5           carry its burden of proof of need for *any* increase in revenue requirement and rates.  
6           RUCO's expert even concluded that APS' data justified a revenue and rate  
7           *decrease!*

8   Q:   **WAS THE ANALYSIS CONDUCTED BY STAFF AND RUCO RELIABLE**  
9       **AND SOUND?**

10 A:   One would certainly hope so. The ratepayers and taxpayers who fund the offices of  
11 RUCO and Staff rightly should expect to be able to rely upon the integrity of the  
12 analyses of Staff and RUCO's hired experts. Presumably Staff and RUCO's expert  
13 analyses were responsibly thorough and intellectually sound. As *independent*  
14 analysts, they should be presumed to have performed their work objectively and in  
15 complete good faith. It should not be expected that they are just "playing a game"  
16 with APS. There should be no automatic presumption that their findings of "no  
17 increase" were merely an opening bid in a negotiation.

18 Q:   **HAVE STAFF AND RUCO HAD TO DEFEND THEIR EXPERT**  
19       **ANALYSES?**

20 A:   No. And because of the Settlement Agreement, they never will. So, one must ask  
21 Staff and RUCO, why were you so quick to abandon your experts' conclusions and  
22 immediately discount your own direct case? Do you not have confidence that your  
23 experts' conclusions and your direct testimony can withstand scrutiny before a  
24 hearing officer and before the Commission?

25 Q:   **IS STAFF AND RUCO'S RESPONSE A RECURRING TREND WITH APS**

26 <sup>4</sup> *Id.*, pp. 5-6.

1                   **RATE CASES?**

2           A:    Yes.  Why have all of the recent APS rate cases resulted in negotiated settlements?  
3               Neither APS nor any other party has had to actually prove or defend its own case  
4               through a bona fide evidentiary hearing on the filed case.

5               In the instant case, once again, the pattern repeats.  APS files an initial direct  
6               case – aiming high at a target they don’t really expect to achieve, with volumes of  
7               self-supporting data, confidently assuming that this case, like previous ones, will  
8               end up in settlement and they will never have to actually prove up the case they  
9               filed.

10              And then what happens?  True to precedent, as soon as Staff, RUCO and  
11              intervenor testimony is filed, APS proposes settlement negotiations and puts on the  
12              table a modified proposal only slightly less aggressive than its filed case.  And  
13              Staff and RUCO – instead of standing firm on their experts’ “no increase” analyses  
14              – promptly began to negotiate against themselves with compromise terms –  
15              including increased rates and revenues, albeit somewhat less generous compared to  
16              APS’ proposal.  And from that point forward the process never revisits Staff’s and  
17              RUCO’s analytically sound position of “no increase.”

18              The entire process starts to look more like only a game of:

19              - ask high, and get told “no, nothing”;  
20              - ask for a little *less*, and get told “well, okay – but not *that* much”;  
21              - then, finally *concede* to *accept* even a little less and get told “well, OKAY,  
22              we’ll *settle* for that . . . and we’ll *all avoid litigation*”.

23              No one seriously re-examines the Staff and RUCO analyses and asks “Why  
24              should APS get *any* more revenue at this time?  Why should current rates be  
25              increased *at all* in the aggregate?  Why aren’t current levels of profit and  
26



1 shareholders' equity good enough? Is APS simply too big to say "NO" to?

2 Q: **WHAT ABOUT INTERVENORS WHO OPPOSE APS OR THE**  
3 **SETTLEMENT PROCESS?**

4 A: Intervenor are subtly pressured to play along in the same game – in the “spirit of  
5 compromise” and the all-important litigation avoidance. As could have been  
6 predicted at the time of the initial filing, deals are struck, the case is settled and  
7 everyone can say to the newspapers that the rate-payers have been protected  
8 because APS *didn't* get *everything it initially asked for*.

9 Q: **WHAT SPECIFIC CONCERNS DO YOU HAVE REGARDING THE**  
10 **TERMS OF THE SETTLEMENT AGREEMENT?**

11 A: I have many. For instance, why agree to the Ocotillo expansion expenditures now,  
12 when sales and loads are steadily decreasing, and reserve generation margins are  
13 increasingly high?

14 In my direct testimony I point out a number of extremely disturbing trends  
15 related to APS operations in recent years, all of which were taken directly from the  
16 annual reports of Pinnacle West, APS' parent company. A review of those reports  
17 shows the following troubling facts, in rounded numbers:

- 18
- 19 • Since 2008 the peak demand on APS' system actually *decreased* from 7,277  
20 megawatts (“MW”) to 7,031 MW.
  - 21 • The Company's annual retail sales *decreased* from over 29,000 gigawatt  
22 hours (GWh) to less than 27,000 GWh.

23 Yet, despite a decreasing demand being placed on APS' system by its  
24 customers, we see that between 2004 and 2015:

- 25 • Depreciated plant *nearly doubled* from \$6.3 Billion to nearly \$12 Billion.
- 26 • Depreciated plant per MW sales *nearly doubled* from \$247/MW to

1                   \$422/MW.

- 2                   • Total retail revenue per megawatt hour of sales *increased* from \$77 to \$117.
- 3                   • Depreciated plant growth per kilowatt ("kW") demand has *increased* from
- 4                   \$1,000/ kW to \$1,680/ kW.
- 5                   • New capital expenditures each year have grown from \$667 Million per year
- 6                   to well over
- 7                   \$1 Billion per year.
- 8                   • Net income has grown from \$32/kW of peak demand to \$64/kW of peak
- 9                   demand.

10                  Perhaps most importantly, APS shareholders' equity has skyrocketed from

11                  \$2.5 Billion to \$4.7 Billion – on the same or reduced customer base! It should be

12                  noted that adjustments for inflation do very little to temper the stark impact of these

13                  numbers. Thus, it appears APS is doing just great for Pinnacle West's shareholders.

14       Q:   **WHAT SHOULD THE COMMISSION BE CONSIDERING WHEN IT**

15           **REVIEWS THIS LATEST SETTLEMENT AGREEMENT?**

16       A:   The Commission ought to be thinking very carefully about the implications of the

17           trends I mentioned earlier. Since the profit formula (for all regulated utilities) is

18           depreciated rate base times return on equity, APS' obvious incentive is to maximize

19           new plant at every opportunity. But is the Commission critically examining the

20           prudence or cost of APS' ever increasing capital expenditures? When does anyone

21           actually make APS prove the prudence and defend the total cost of its capital

22           expenditures? When was the last *actual* Cost of Service Study performed and

23           thoroughly vetted by the Commission, – as opposed to relying simply on costs

24           "modeling"? Does anyone critically examine the details of APS' general and

25           administrative expenses that are capitalized into rate base as construction overhead

26

1 or "loading" charges? If such items are *not* examined in detail in a rate case, then  
2 when, and by whom?

3 **IV. CONCLUSION**

4  
5 **Q: DO YOU HAVE ANY CONCLUDING REMARKS?**

6 **A:** In sum, my objection to the Settlement Agreement is that, like all of its predecessor  
7 settlements, it allows APS to circumvent the detailed scrutiny and proof of its filed  
8 case in general, and its capital expenditures and rate base in particular. Before this  
9 Commission approves the continuation of the trends of the past decade, a thorough  
10 examination of APS' continued growth in plant and rate base, notwithstanding  
11 declining demand and sales, must be undertaken.

12 **Q: DOES THIS CONCLUDE YOUR TESTIMONY?**

13 **A:** Yes.  
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